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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Concern Over The Financial Structure . . .

Despite widespread expectations that interest rates would rise in the second half of 1982, so far at least, precisely the opposite has occurred. Fueled by a five and one-half percentage point drop in the Federal funds rate since late June, powerful financial market rallies have reduced interest rates across the entire maturity spectrum. But while undoubtedly welcome, these interest rate declines have served to mask a continued deterioration in the business outlook. Faced with an economy yet to exhibit signs of recovery and well-publicized problems in the financial system—not to mention the soaring credit needs of the Treasury—the Federal Reserve has loosened the monetary reins. In so doing, bank reserve pressures have been eased, thereby pushing interest rates sharply lower.

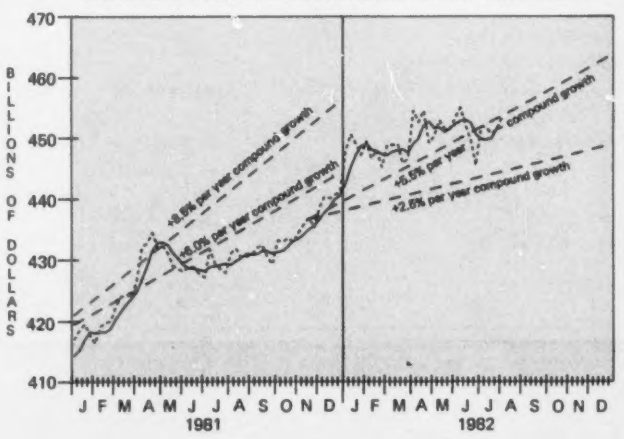
Over the past six weeks, the Fed has repeatedly signaled the financial markets, through both open market operations and discount rate reductions, that it desired not only lower interest rates, but also that it would not tolerate any prolonged backup in rates at this time. For example, despite the sizable $2 billion bulge in the money supply in early August, which placed its year-to-date growth once again near the top of its upper target boundary, the markets—which have usually reacted negatively to such developments—scarcely noticed this time (see chart opposite). Their attention was instead focused on the simultaneous announcement of another one-half percentage point reduction in the Federal Reserve's discount rate, the third within the space of a month, to 10.50 per cent. What is more, the central bank has also been generously providing reserves to the banking system. During the month ending August 11, these building blocks of the money supply expanded at a torrid 26.5 per cent seasonally adjusted annual rate. This is an abrupt turnaround compared with the almost one per cent seasonally adjusted annual rate decline posted during the month ending June 30.

At the same time, the banking system's need for such reserves has not kept pace. Required reserves have actually declined over the past few weeks, reflecting the midsummer slowdown in the growth of the money supply. These trends resulted in a substantial imbalance between the demand for and supply of reserves in the banking system, thus facilitating the sharp decline in interest rates.

. . . Prompts The Fed To Ease

The easing of Federal Reserve policy can only continue, however, as long as money supply growth remains subdued—if the Fed has not decided to abandon altogether its monetarist principles. And since there does not yet appear to have been any basic change in the Fed's intolerance to prolonged periods of above-target money supply growth, a spurt in the money supply could present the central bank with significant problems later this year.

MONEY SUPPLY, M1
FOUR-WEEK MOVING AVERAGE (LINE) VS. WEEKLY FIGURES (DOT)



The combination of repeated discount rate cuts, the sharp upturn in nonborrowed reserves growth and the steep drop in the Federal funds rate within just a few weeks, suggests a degree of monetary easing unmatched since the spring and early summer of 1980. At that time, the discount rate was cut in three steps by three full percentage points, nonborrowed reserves expanded at an approximately 25 per cent seasonally adjusted annual rate, and the Federal funds rate tumbled from just about 20 per cent at the end of March, 1980, to less than nine per cent by the middle of June.

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But while undoubtedly setting the stage for the modest economic rebound which did occur in the second half of 1980, the aggressive easing by the Fed also resulted in a $17 billion spurt in M1 within three months and a $25 billion jump within five. As a result, M1 soared from $4 billion below its *lower* growth target boundary in June, 1980, to almost $3.5 billion above its *upper* target boundary in November of that year. This, in turn, prompted a reversal of monetary policy, with higher interest rates the result. And although the economy is weaker now than in 1980 while inflation rates are much lower, the combination of bigger credit demands by the Treasury, substantial monetary policy stimulation and money supply growth already near the top of its target boundaries could be a recipe for higher—not lower—interest rates before long.

The Light At The End Of The Tunnel . . .

As for the economy, it continues bumping along a rocky bottom with no evidence of a rebound. The drop in money market interest rates has not yet changed things for the average consumer. This means that interest rates are still high enough to discourage potential buyers of big ticket items requiring credit. For example, on average, credit card users pay a finance charge of almost 20 per cent (although these vary widely according to state usury laws). What is more, in recent weeks

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 8/11/82	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	140.905	– .048	+ 9.244
Loans to Depository Inst.	.369	– .311	– .895
Float	2.335	+ .110	– 1.268
Total Reserve Bank Credit	153.759	+ .317	+ 7.596
Treasury Deposits with Federal Reserve Banks	3.950	+ .306	+ .336
Currency Outside Banks	132.356	+ .862	+ 7.811
Member Bank Reserves:			
Required	39.138	– .544	– .756
Excess (Deficiency)	.358	+ .084	+ .156
Total Reserves Held	39.496	– .460	– .600
Net Free Reserves	.122	+ .362	+ .961
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	95.821	– 2.067	+ 4.314
Monetary Aggregates†		**% Change Since Three Months Ago***	**% Change Since Year Ago**
M1	453.4	0.4‡	+ 5.2‡
M2 (July '82)	1,922.7	+ 8.9	+ 9.6
M3 (July '82)	2,319.7	+ 10.9	+ 10.3
L (March '82)	2,716.8	+ 11.2	+ 11.4

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 8/20/82	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	6.75%	8.25%	9.05%
* Federal Agencies	9.15	11.45	12.30
* Project Notes—Taxfree (46% Taxable Equivalent)	8.89	9.26	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	9.75	10.55	11.50

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.50%	Sep.	8.80%
15- 29 days	7.75	Oct	9.00
30- 59 days	8.00	Nov.	9.50
60- 89 days	8.38	Dec.	9.60
90-179 days	8.50	Jan.	10.00
180-239 days	9.00	Feb.	10.00
240-270 days	9.00		

‡Industrial Paper—Prime			
30- 89 days	8.00%	†Federal Funds Effective Rate	8.65%
90-120 days	8.38		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'82	$ 3,041	$ 2,996	$ 2,902
Gross National Product (1972 Dollars)*	2nd Q'82	$ 1,475	$ 1,471	$ 1,502
Percent Change, Annual Rate	2nd Q'82	1.3	– 5.1	– 1.5
Change in Consumer Prices (all urban consumers)*	Jun '82	12.0%	12.0%	8.4%
Change in Producer Prices*	Jul '82	7.2%	12.0%	4.8%
Civilian Employment (Thousands of Persons)†	Jul '82	99,732	99,764	100,864
Unemployment as % of Civilian Labor Force†	Jul '82	9.8%	9.5%	7.2%
Personal Income	Jul '82n	$2,592	$2,567	$2,436
Leading Indicators Composite Index (1967=100)†	Jun '82	127.9	127.9	135.2
Industrial Production Index (1967=100) †	Jul '82	138.1	138.2	153.9
Net Change in Consumer Installment Credit†	Jun '82	$ 1.35	$ 1.40	$ 2.03
U.S. Merchandise Trade Balance †	Jun '82	–$ 3.44	–$ 3.29	–$ 3.28
Plant and Equipment Expenditures*	3rd Q'82	$328.04(a)	$336.77(a)	$328.25
Private Housing Starts (Thousands of Units)*	Jul '82	1,211	906	1,040
New Construction Expenditures*	Jun '82	$ 230.7	$ 227.7	$ 237.5
Total Business Inventories†	Jun '82	$ 512.0	$ 510.4	$ 501.4
Total Business Sales†	Jun '82	$ 344.5	$ 349.1	$ 356.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

some banks have notified their customers of rate increases, while others will impose additional fees.

Durable goods manufacturers or even retailers of such softgoods as textiles and apparel find little to cheer about when it comes to consumer loan rates. While the use of charge cards used to make buying decisions somewhat easier, now people have become more cautious and selective. This is evidenced by smaller rises in purchases on credit. Since the start of the 1980 recession, the use of revolving credit has expanded at an average $270 million per month, about one-third the average increase posted in the previous 29 months. Similarly, the drop in interest rates has not brought relief to potential homebuyers or homebuilders. With mortgage rates on 25 year loans still close to 17 per cent, single family housing starts continue their protracted decline.

. . . Is Getting Dimmer

Unlike mortgage payments, monthly automobile payments are only affected slightly by fluctuating interest rates (Financial Digest—August 17, 1981). However, a decline in rates seems to have a positive psychological effect on shoppers, and has previously given a boost to new car sales, witness the success of GM's 12. 8 per cent financing earlier this year. Currently, the average interest rate on car loans at commercial banks is above 17 per cent—only 16

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (8/4/82)	146,289	+ 1,425	+20,495
New York City (8/4/82)	38,358	+ 1,436	+ 7,838
Commercial Paper (8/4/82)	180,258	– 1,568	+29,173

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (8/4/82)	210,974	+ 474	+26,258
New York City (8/4/82)	59,412	+ 96	+ 5,127

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (8/4/82)	492,333	+ 4,147	+43,181
New York City (8/4/82)	116,668	+ 2,603	+ 8,492

Financial Markets

	Friday 8/20/82	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.25%	– 1.90	– 8.95
180-Day Bills†	9.05	– .50	– 7.80
Longest Bills†	10.10	– 1.39	– 6.46
Recent Issues:			
13 1/8s 7/31/84	11.20	– 1.15	
14 7/8s 6/30/86	12.05	– 1.06	
13 3/4s 5/15/92	12.30	– .97	
14s 11/15/11	12.18	– .38	
Municipals:			
Bond Buyer–20 Bond Index* (8/19/82)	10.82%	– 1.04	– 1.12
Blue List Total ($ Million)	$ 745	– $204	– $ 55
30-Day Visible Supply ($ Million)	$1,793	– $ 25	– $190
Total	$2,538	– $229	– $245
Corporates:			
Moody's Aa Composite (8/19/82)	14.12%	– .78	– 1.25
30-Day Visible Supply ($ Million) ‡	$1,125	– 0 –	NA
Stocks:			
Dow-Jones Averages:			
Industrials	869.29	+ 81.24	– 51.28
Transportation	324.04	+ 28.55	– 71.75
Utilities	115.36	+ 9.05	+ 2.63
65 Stocks	333.65	+ 29.91	– 29.91
Standard and Poor's 500 Stocks	113.02	+ 9.17	– 16.21
N.Y.S.E. Composite Index	64.65	+ 5.11	– 10.45
N.Y.S.E. Avg. Daily Vol. for Week (000's)	91,172	+40,958	+ 50,408

* 46% Taxable equivalent 20.04%.
‡ Series redefined: Historical data not available.
† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 8/20/82	Week Ago
Overnight	9.13%	10.00%
1 month	9.88	11.25
3 month	10.31	11.88
6 month	11.25	12.75
1 year	12.06	13.00
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	13.35%	13.95%
Long Term (7 to 15 yrs.)	13.60	14.20

FOREIGN EXCHANGE SPOT RATES New York Opening (8/20/82)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02120	47.16
Canada	.8087	1.2365
Denmark	.1170	8.5478
France	.1455	6.8750
Germany	.4072	2.4555
Italy	.0007225	1384.10
Japan	.003912	255.65
Mexico	.009302	107.50
Netherlands	.3702	2.7010
Switzerland	.4805	2.0810
U.K.	1.7432	.5737

basis points below the most recent peak reached in the final quarter of 1981.

What is more, persistently high long-term interest rates are one of the major culprits behind the halt in capital spending. Although they have come down somewhat in recent weeks, long-term interest rates are not low enough to spur expenditures on new plant and equipment. In fact, the nation's businesses are apparently continuing to scale back their spending plans. According to a recent Commerce Department survey, businessmen plan to spend 2.2 per cent more for expansion and modernization in 1982 over 1981 levels, whereas three months earlier they projected a 7.3 per cent increase. In additon, since June, a number of large companies, especially in the steel, textile and electronics industries, disclosed further reductions—signaling that 1982's capital spending may even dip below 1981 levels. When the effects of inflation are factored out, real capital spending has not increased since early 1979—the longest pause in recent memory.

To be sure, an increase in the pace of business must also occur before manufacturers contemplate any expansion program. This may be long in coming. Indeed, a recent survey of purchasing managers of major U.S. corporations, suggests that the economy weakened further in July. Not only did production levels deteriorate, but incoming orders—harbingers of future production and employment levels—slowed further. What is more, 90 per cent of the managers told of either stable or declining prices of materials. While this may be good news on the inflation front, it also implies that demand may still be slowing down. This could mean further cutbacks in capacity utilization and a scaling down of capital spending plans. ■

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For the period 1972-1981, the MH Fixed Income Fund delivered far greater returns than the Salomon Bros. Index and the P.I.P.E.R. Median.

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For example, Manufacturers Hanover went beyond the concept of bond immunization to that of contingent immunization. This allows our portfolio managers to actively trade bonds, as long as the overall rate of return remains above a predetermined "floor." If the return hits the "floor," the portfolio is immunized to lock in the original targeted yield.

While contingent immunization does not guarantee the return, long term simulation, historic analyses and Manufacturers Hanover's actual experience indicate a likelihood of maintaining the floor with a high degree of probability.

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To learn how the Manufacturers Hanover active approach to pension fund management can affect your plan, contact William C. Petty, III, Vice President, at (212) 957-0760. Or write to him at the address below.

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*These numbers are annual time weighted rates of return for the ten year period ending December 31, 1981.
†Pension and Investments Performance Evaluation Report–Pooled Fixed Income Funds of Banks and Insurance Companies